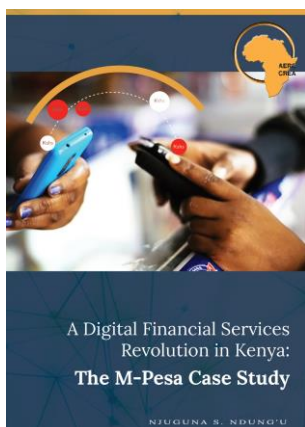


A Digital Financial Services Revolution in Kenya: The M-Pesa Case Study

By Njuguna S. Ndung'u

Professor Njuguna Ndung'u former Governor of the Central Bank of Kenya, has just published his personal reflections on the M-Pesa journey. This is the foreword I was honoured to be asked to write for the study.



Foreword¹

In 2007, I participated in the launch of M-Pesa where Prof. Njuguna Ndung'u, the Governor of the Central Bank of Kenya, stated that he had allowed M-Pesa to operate, but that the Central Bank would regulate M-Pesa once it understood what it was regulating (this is what in later years has been described as 'Test and Learn' approach and a Regulatory Sandbox). That moment represented the start of M-Pesa's public journey, which became proof of a concept that has influenced the development of financial services across the world. Today, because of M-Pesa and the agent banking that followed in response, over 86% of adult Kenyan's are financially included. It's an impact no one at the time could have predicted.

In this paper, Prof. Ndung'u provides a unique, personal perspective of the development of M-Pesa. He discusses the need as a regulator to balance innovation and systemic risk while promoting competition. Competition was of itself a difficult concept when regulating an innovation being launched by a monopoly into a market for financial services containing dominant institutions. He is frank about the pressure he faced from the banking sector and policy makers and how these challenges were addressed.

The paper characterizes generations of M-Pesa, covering initial growth, bank linkages, digital credit, international remittances and fintech. It further notes the monetary policy impact of M-Pesa in the velocity of money circulation and the money multiplier in the money supply process that pushed the changes in monetary policy framework. These generations demonstrate how the continuing journey of M-Pesa, which has hugely benefited Kenyans, has facilitated rapid growth in financial technology and stimulated digital government and digital transformation. The story continues, and there will be future M-Pesa generations. M-Pesa's success is lauded both by Prof. Njuguna Ndung'u and his successor at the Central Bank, Patrick Njoroge.

Despite this success, or arguably because of it, policy makers must now contend with new challenges: to competition, technology-based barriers to entry, interoperability, data protection, data privacy, cybersecurity, disintermediation, and financial technology - in a system dominated by a few successful providers. The final section of the paper focuses on learnings and outcomes from the Kenyan experience. These lessons include the need to develop or enhance 'information capital'

¹ This is the foreword I wrote for Professor Njuguna Ndung'u's paper. The paper can be accessed on: <https://aercafrica.org/latest-news/a-digital-financial-services-revolution-in-kenya-the-m-pesa-case-study/>

systems, the impact on payment systems and social payments, and the impact on financial innovation of M-Pesa. Lessons for regulators are provided on how to promote innovation through innovation offices, sandboxes, and reg-tech.

Prof. Ndung'u closes the paper by discussing future challenges, including those related to full account interoperability, and the need for internet connectivity across the country for people to be able to participate in the digital finance revolution, and electronic identification system to secure the market. He notes the challenges for regulators to address, including emerging cybercrime, and the need to create an enabling framework for alternative finance - specifically crowdfunding.

For me, the importance of this paper comes from the insights from Njuguna Ndung'u's unique perspective as a Professor of Economics and as a Governor of the Central Bank of Kenya. He was someone who followed principles with purpose and who navigated between multiple interests to help give birth to a transformational vehicle for financial inclusion and the start of digital finance revolution in Kenya. Certainly, much remains to be done, but so much has been achieved.

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This blog is one of a series of blogs, should you wish to sign up to receive additional blogs, please write to David Cracknell at david@firstprinciples.consulting

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